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SUBJECT: INVESTMENT IN SOUTH INDIA CONTINUES, AS DO JITTERS ABOUT THE ECONOMY

REFS: A) NEW DELHI 2908, B) CHENNAI 359

¶1. (SBU) Assistant US Trade Representative Michael Delaney met on November 10 with business leaders from key sectors of South India's economy, urging progress on the WTO Doha Round and assessing how the region's business are weathering the current economic slowdown. While all of Delaney's interlocutors could point to softness in their markets, they were generally upbeat about their companies' abilities to weather the current storm and prosper over the longer term. Most complained far more about Tamil Nadu's power problems than about current market conditions. Some of the optimism may reflect simply an unwillingness to appear too downbeat in front of a foreign government official, but observable evidence suggests that at least some companies in South India continue to expand their investments in key sectors, suggesting long-term optimism about the region's ability to provide adequate returns.

A/USTR promotes Doha Round and discusses the economy

¶2. (U) Assistant U.S. Trade Representative for Central and South Asia Michael Delaney visited Chennai November 9-11 as part of his tour of India and Sri Lanka to promote the resumption of the Doha Round and to gain a keener sense of the region's economy during the current worldwide economic turmoil. He spoke with executives working in South India's key industrial sectors, including automobile manufacturing, information technology, and textiles. He also met leaders from the region's top chambers of commerce and the financial sector.

Plenty of evidence about difficult market conditions

¶3. (SBU) All of Delaney's interlocutors offered evidence about the slowing economy. An executive from a textile company that makes lingerie for the U.S. market said that earlier this year he forecasted export revenues of USD 22 million -- up from USD 17 million in 2007 -- but now expected to generate only USD 15-16 million this year. He said that this time of year should be his company's busiest, in preparation for the U.S. holiday season, but that he was actually scaling back production because of the drop in orders.

¶4. (SBU) Other business leaders were less precise, but conveyed similar messages. An automobile-component manufacturer told Delaney, "we've hit an air pocket. We know we're going to fall, but we don't know how far." He added that both Hyundai and Ford have reduced production volumes in recent weeks. An executive from a mid-sized information technology (IT) company said that his company was still formally expecting to hit its target of USD 300 million in revenue this year, but admitted that it was almost certain to fall short.

¶5. (SBU) A Ford executive told Delaney that he expected sales of his company's vehicles in India to grow by about six percent this year. While admitting that this figure is only about half of what Ford has grown accustomed to in the Indian market in recent years, he said that the timing was not particularly bad, because a slowdown will make it easier for Ford to manage its \$500 million expansion. (The expansion will allow Ford to produce a sub-compact car by 2010 for the Indian market, a market segment in which it at present has no model.) He explained that his company was still building all of the external infrastructure (buildings, roads) necessary for the expansion, but was holding off on purchasing some of the most expensive, new machinery (like automated metal presses), until market conditions created adequate demand for these upgrades. He told Delaney that 2009 was going to be a difficult year, but that things should pick up nicely by 2010.

¶6. (SBU) Executives at Timken's Chennai facility, which makes bearings for large trucks, explained to Delaney that their plant is largely unaffected by the current downturn in worldwide economic conditions. They said that their facility produces a very specialized product, and that all of its production is exported to the United States. The executives admitted, however, that Timken's operations in India as a whole (the Canton, Ohio-based company has three facilities in India) were suffering because of softness in demand.

¶7. (SBU) A top executive at Cognizant, a U.S.-based IT company that has its India operations based in Chennai, told Delaney that parts

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of the IT sector continue to do well. He said that most of India's big IT players are investing in Tamil Nadu as they try to ramp up their capacity to work on aerospace and defense projects, which the industry sees as key growth sectors. Demand for engineers with skills in these areas is high, he said, and companies are having difficulty hiring enough people with the right skills. He also said, however, that demand for the banking and financial services that have long been the mainstay of India's IT services companies has been falling.

And not all the bad news comes from the economic slump

¶8. (SBU) While most of Delaney's interlocutors could point to both positive and negative signs in the market, all expressed dismay about a more immediate problem: Tamil Nadu's shortfall in electricity. One businessman said that companies in the state routinely need to operate on their diesel-powered backup generators four to six hours per day. (A textile manufacturer told us in October that some parts of the state, including the textile hub of Coimbatore, are without power from the grid for up to 10 hours per day.) Another said that he needs to operate his backup generator approximately one-half to one-third of his production hours. As if to emphasize the point, the lights went out briefly at a textile plant while Delaney was visiting, as the facility switched from grid to backup power.

¶9. (SBU) All complained about the extra costs this imposes. Even executives at Ford and Visteon, whose companies benefit from a special arrangement with the state that provides them continuous power from the grid, complained that their suppliers are having a difficult time making ends meet because of the electricity disruptions and the additional costs backup power imposes.

¶10. (SBU) Delaney's interlocutors said that the situation should get better in two years, when several new power plants come online, but stressed that the state needed to take drastic action in the interim. A Visteon executive presented Delaney with a formal list of steps the government could take in the short-term to alleviate the situation. These included:

-- allowing power producers to sell directly to consumers, bypassing the Tamil Nadu Electricity Board (NOTE: the state government has

approved a policy that permits this under certain conditions. END
NOTE.);
--eliminating power subsidies sectors like agriculture, which
receives electricity free of charge; and
--increasing non-conventional capacity, like installing sea-based
windmills.

¶11. (SBU) Other businessmen told Delaney that the government should obtain "power barges," portable, sea-based power generating stations that can supply electricity to the state. (Businessmen and some government officials have told us this before. Many here contend that Russia has several of these barges that could easily be brought to India's southern coast and tethered to the grid to provide additional power.)

A tale of two markets

¶12. (SBU) The effects of these uncertain economic times can have some unexpected side effects, and can impact different companies in the same industry differently. According to November 12 reports, the president of a textile-exporting association said that drops in orders could result in up to 20,000 workers losing their jobs in the "knitwear cluster" in and around Tirupur (a city in west-central Tamil Nadu).

¶13. (SBU) An executive at a textile manufacturer that Delaney visited, however, noted that some companies face a different problem. He cited two companies in the Tirupur area that serve the domestic market were facing a labor shortage. He said that many workers from these companies had gone home to their villages to celebrate the Deepavali (Diwali) holiday in late October and had simply not returned to work, since the arrival of the rainy season allowed them to return to agricultural work.

¶14. (SBU) He explained that workers producing for the domestic market receive lower wages than their higher-skilled peers producing exportable products. This means that workers laid off from export-oriented companies are generally unwilling to take lower-paying jobs at companies that produce for the domestic market, even though those companies need more labor. He predicted that

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domestic producers would end up increasing wages to attract workers.

Comment

¶15. (SBU) While Delaney's interlocutors were concerned about current economic conditions, most were generally upbeat about the long-term future of their companies. Some of this optimism may have been a brave face put on to impress a foreign government visitor, but all seemed to see the current situation as a relatively short-term obstacle. Evidence that a widespread recession in the West would be deeper or last longer than expected, or that India's economy faced a drastic deterioration might change minds, but given current conditions, most business leaders in South India seem to believe that they will weather the current storm and eventually prosper again.

¶16. (U) A/USTR Delaney cleared this cable.

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